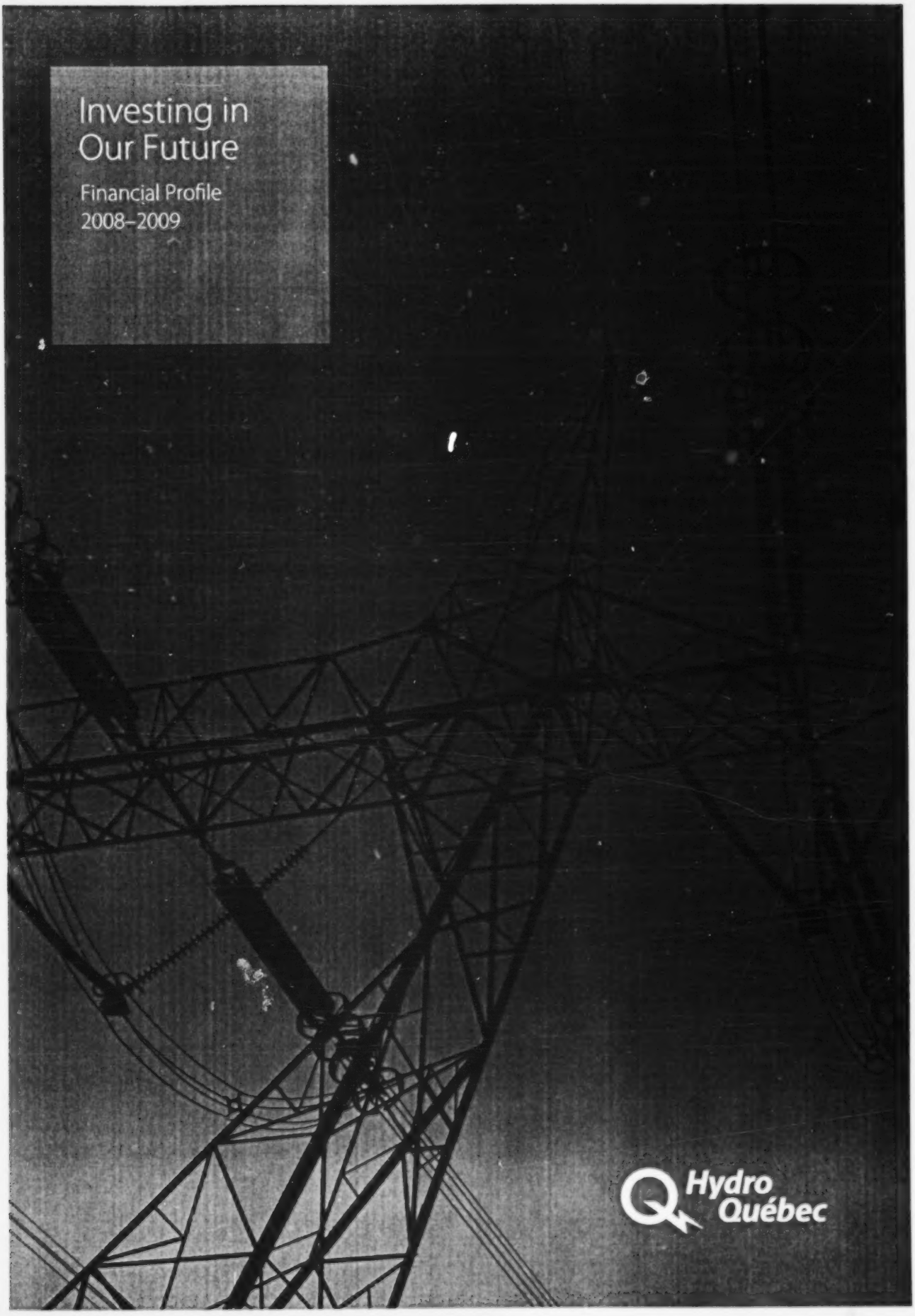
Investing in Our Future

Financial Profile 2008–2009



Hydro Québec

Investing in Our Future

Financial Position
Financing
Issues

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Prospective Information

This document contains statements of a prospective nature. They entail risks and uncertainties which may mean that Hydro-Québec's actual future results may differ considerably from those forecast. A number of risks and other factors to which Hydro-Québec is exposed may lead to changes in the results and events anticipated.

These include, but are not limited to, competition, the economic environment, the business environment and Hydro-Québec's ability to achieve its strategic business objectives. Moreover, these prospective statements must in no way be interpreted as guarantees or assurances from Hydro-Québec as to its future results.

Units of Measure

kV
kilovolt
(unit of voltage)

MW
megawatt
(unit of power)

kWh
kilowatthour
(unit of energy)

MWh
megawatthour, or one thousand kilowatthours

GWh
gigawatthour, or one million kilowatthours

TWh
terawatthour, or one billion kilowatthours

$M
millions of dollars

$B
billions of dollars

Currency

Unless otherwise indicated, monetary amounts are expressed in Canadian dollars.

Executive Summary

Hydro-Québec generates, transmits and distributes electricity. The company's *Financial Profile 2008–2009* describes its financial position, financing and debt management. Highlights of the report are:

- Despite the worldwide financial crisis, Hydro-Québec posted a strong performance in 2008, mainly as a result of higher net electricity exports. Our sales figure totaled $12,717 million, up $387 million, and net income rose to $3,141 million from $2,907 million in 2007.
- The company has maintained ratios that demonstrate its sound financial health. Interest coverage has held steady at 2.12 while return on equity remains about 15%. The dividends payable to our sole shareholder, the Québec government, amount to $2,252 million for 2008.
- To finance a portion of its investments, which total approximately $4 billion to $5 billion per year in 2008 and 2009, Hydro-Québec turns to the bond market. For several years, our annual financing needs of nearly $2 billion have been met exclusively on the Canadian market.
- Hydro-Québec is continuing to develop hydropower, a clean, renewable energy source. Installed capacity currently stands at 36,429 MW, and our portfolio of projects comprises more than 1,000 MW in facilities under construction and 1,550 MW in projects awaiting government approval.
- In 2008, Hydro-Québec decided to proceed with the refurbishment of its only nuclear generating station, Gentilly-2. The bulk of the work will take place in 2011 and 2012.
- Developing the transmission grid will call for capital expenditures of approximately $1.5 billion in 2009: 45% to maintain and upgrade facilities, and 55% to expand the grid, including the construction of a new interconnection with Ontario.
- The company's assets total $66.8 billion. Long-term debt includes $34.9 billion in debentures and medium-term notes that are guaranteed unconditionally by the Québec government.

Sustainable development remains a matter of critical importance to the company. This takes concrete shape in all facets of its activities as well as in its commitment to concentrate on renewable energies.

Financial Profile covers from 2003–2008.

Message from the
Vice President, Financing,
Treasury and Pension Fund

Strong Growth

Hydro-Québec ended fiscal 2008 with $3,012 million in income from continuing operations, up $130 million from the previous year. Despite the worldwide financial crisis, the company continues to show strong growth. The rise in income—which topped the $3-billion mark for the first time—is mainly attributable to the $380-million increase in net electricity exports by Hydro-Québec Production. This, in turn, contributed to the 3% growth in sales figure compared with 2007.

These excellent results will enable us to pay our shareholder, the Québec government, dividends of $2,252 million, bringing to $9.2 billion the total amount paid since 2004. Interest coverage held steady at 2.12 and return on equity is 15.4%, versus 15.0% in 2007.

The company's solid financial health is the result of certain key factors, including its active yet prudent presence on markets in the U.S. Northeast, careful cost and debt management, low-risk diversification of operations, and thorough project planning and follow-up.

A sound development strategy

Hydro-Québec's growth is based on a development strategy backed by a substantial investment program, which totaled $4.0 billion in 2008. In the past few years, we have commissioned a number of major hydropower facilities, such as Eastmain-1 (507 MW) and Toulnustouc (526 MW). The last two generating units at Péribonka (385 MW) went into operation in 2008, and the Chute-Allard and Rapides-des-Cœurs project (138 MW) will come on stream in 2009. North of the 49th parallel, we are continuing construction on the Eastmain-1-A/Sarcelle/Rupert development, which is moving ahead on time and on budget. This $5-billion project will add 918 MW in capacity and 8.7 TWh in output to our generating capacity.

The next major hydropower project, the Romaine complex, as completed the public-hearing phase. Four generating stations are to be built on the Romaine, for a total installed capacity of 1,550 MW and additional output of 8.0 TWh. Construction is scheduled to begin in the second quarter of 2009, and commissioning will take place in stages from 2014 to 2020. With investments of $6.5 billion, this will be the largest infrastructure project in Canada.

Hydro-Québec's active yet prudent presence on markets in the U.S. Northeast, careful cost and debt management, and thorough project planning and follow-up contribute to the company's solid financial health.

Jean-Hugues Lafleur

Adding new hydropower developments and integrating wind farm output necessarily entails developing the transmission grid. We invested over $1 billion in this in 2008. As a result, we were able to bring Péribonka, Rapides-des-Cœurs and Chute-Allard hydroelectric generating stations onto the grid and step up the integration of wind power. At the same time, we are increasing transmission capacities for interchanges with neighboring systems. Phase I of a new, 1,250-MW interconnection with Ontario—a $654-million project—will be commissioned in 2009.

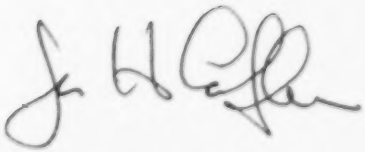
A consistent presence on financial markets

The scale of our investments requires financing a portion on the bond market. Borrowings in 2008 totaled $2 billion with the issuing, on four different dates, of bonds maturing in 2045, at an average cost of 4.91%. As well, the company is ending the year with substantial liquidity and a cash position of $4 billion. Our 2009 borrowing program should total $2.1 billion.

Holding course

The principles of sound management and good governance that have served Hydro-Québec well in the past will continue to guide our development. Despite the current weakening of economic conditions, we plan to optimize our financial results by keeping up our careful risk management. Hydro-Québec expects to achieve net income of $2.7 billion in 2009, entirely from continuing operations. In addition, we will file our *Strategic Plan 2009–2013*, which will present the company's financial context and main business objectives for the next five years.

We are proud of the results posted in 2008 and maintain our confidence in the effectiveness of our development strategy. This strategy is based on major investments supported by a financing program that has proven its worth, and carried out with profitability and sustainability in mind.



Jean-Hugues Lafleur

Vice President, Financing, Treasury and Pension Fund

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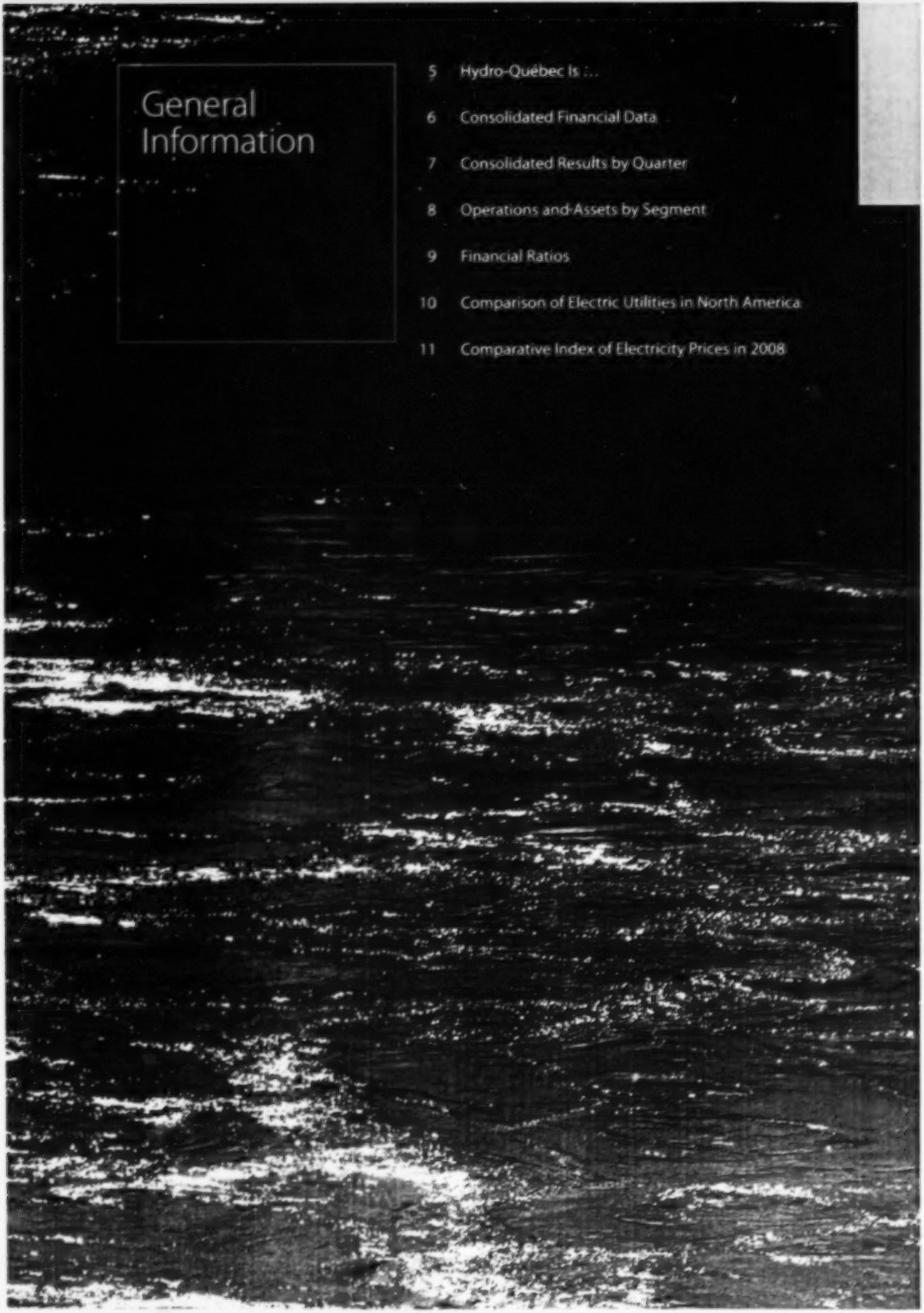


Hydro-Québec Is . . .

Hydro-Québec generates, transmits and distributes electricity. It is responsible for providing Quebecers with a secure electricity supply. To meet growing demand, it is continuing to develop hydropower, complemented by wind power purchased from independent producers.

Hydro-Québec also conducts energy-related research and develops new generation, transmission and distribution technologies. The company has actively promoted energy conservation for a number of years by offering energy efficiency programs for all customer categories.

To meet its financing needs, Hydro-Québec turns to the bond market. Its sole shareholder is the Québec government, which guarantees most of its borrowings (see page 27). As of December 31, 2008, Hydro-Québec's assets totaled $66.8 billion while its total debt amounted to $36.4 billion.

In accordance with the *Hydro-Québec Act*, the company declares annual dividends which cannot exceed the distributable surplus or no more than 75% of its net income, provided it maintains a capitalization rate of at least 25%.

The consolidated financial data presented in the Financial Profile 2008–2009 include the accounts of Hydro-Québec, its subsidiaries and its joint ventures.

To preserve particular landscapes, we completed underground hookups for 16,200 new residential customers in 2008.

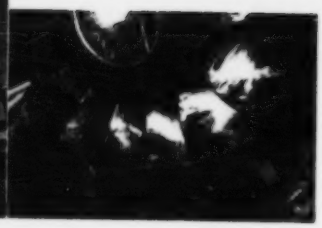
Consolidated Financial Data

	2004	2005	2006	2007	2008
OPERATIONS (in millions of dollars)					
Revenue	10,341	10,887	11,161	12,330	**12,717**
Expenditure					
Operations	2,154	2,245	2,389	2,541	**2,497**
Electricity and fuel purchases	1,464	1,496	1,315	1,555	**1,406**
Depreciation and amortization	1,862	2,023	2,007	1,991	**2,336**
Taxes	610	597	534	553	**541**
Water-power royalties[1]	–	–	–	267	**552**
Regulatory deferrals	–	(11)	(93)	29	**(72)**
Total	6,090	6,350	6,152	6,936	**7,260**
Operating income	4,251	4,537	5,009	5,394	**5,457**
Financial expenses	2,083	2,186	2,212	2,512	**2,445**
Income from continuing operations	2,168	2,351	2,797	2,882	**3,012**
Income (loss) from discontinued operations	267	(99)	944	25	**129**
Net income	2,435	2,252	3,741	2,907	**3,141**
BALANCE SHEET SUMMARY (in millions of dollars)					
Total assets	58,072	60,431	63,254	64,866	**66,774**
Long-term debt, including current portion and perpetual debt	33,401	33,007	34,427	34,534	**36,415**
Equity	16,220	17,376	18,840	20,892	**22,062**
INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH (in millions of dollars)					
Property, plant and equipment and intangible assets	3,071	3,293	3,348	3,464	**3,756**
Costs related to Energy Efficiency Plan	41	91	149	172	**236**
Total investments	3,112	3,384	3,497	3,636	**3,992**
OPERATING STATISTICS					
Installed capacity[2] (in MW)	33,892	34,571	35,315	35,647	**36,429**
Peak power demand in Québec[3] (in MW)	34,956	33,636	36,251	35,352	**37,230**
Total energy requirements[4] (in TWh)	193.0	200.2	199.5	209.8	**211.2**
Electricity sales in Québec (in TWh)	165.9	169.2	167.3	173.2	**170.4**
Electricity sales outside Québec (in TWh)	14.4	15.3	14.5	19.6	**21.3**
Total electricity sales (in TWh)	180.3	184.5	181.8	192.8	**191.7**
Total workforce	21,904	22,131	22,587	23,069	**22,916**
Number of customer accounts	3,701,275	3,752,510	3,815,126	3,868,972	**3,913,444**

Note: Certain comparative figures have been reclassified to reflect the presentation adopted in the current year.

1. As of 2007, Hydro-Québec has been required to pay water-power royalties under the terms of the Watercourses Act. For 2007, a transition year, the half-rate rule applied.
2. Hydro-Québec also has access to most of the output from Churchill Falls generating station (5,428 MW) and purchases all the output from eight privately owned wind farms with a total installed capacity of 130 MW. In addition, 1,277 MW are available under agreements with independent suppliers.
3. Total power demand at the annual domestic peak for the winter beginning in December, including interruptible power. The 2008–2009 winter peak for Québec occurred at 8 a.m. on January 16, 2009.
4. Total energy requirements consist of kilowatthours delivered within Québec and to neighboring systems.

The switchyard at Manic-5 generating station.

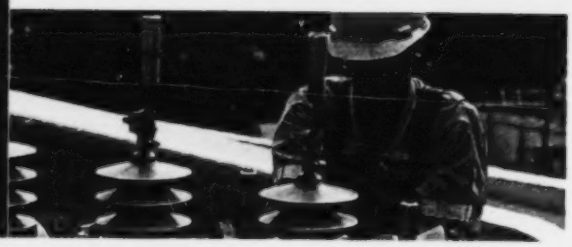


Refurbishing a turbine runner at Outardes-4.

Consolidated Results by Quarter

(in millions of dollars)	1st quarter	2nd quarter	3rd quarter	4th quarter (unaudited)	Year (audited)
2008					
Revenue	3,771	2,960	2,814	3,172	**12,717**
Expenditure					
Operations	614	629	601	653	**2,497**
Electricity and fuel purchases	337	329	364	376	**1,406**
Depreciation and amortization	575	577	525	659	**2,336**
Taxes	298	230	239	326	**1,093**
Regulatory deferrals	(1)	(116)	–	45	**(72)**
Total	1,823	1,649	1,729	2,059	**7,260**
Operating income	1,948	1,311	1,085	1,113	**5,457**
Financial expenses	615	595	598	637	**2,445**
Income from continuing operations	1,333	716	487	476	**3,012**
Income from discontinued operations	117	5	4	3	**129**
Net income	1,450	721	491	479	**3,141**
2007					
Revenue	3,732	2,813	2,554	3,216	**12,330**
Expenditure					
Operations	606	616	597	722	**2,541**
Electricity and fuel purchases	422	337	441	355	**1,555**
Depreciation and amortization	482	477	472	560	**1,991**
Taxes	208	188	200	224	**820**
Regulatory deferrals	(14)	(14)	(15)	72	**29**
Total	1,704	1,604	1,695	1,933	**6,936**
Operating income	2,028	1,224	859	1,283	**5,394**
Financial expenses	618	589	642	663	**2,512**
Income from continuing operations	1,410	635	217	620	**2,882**
Income from discontinued operations	21	–	–	4	**25**
Net income	1,431	635	217	624	**2,907**

Hydro-Québec Équipement and Société d'énergie de la Baie James (SEBJ) had a total volume of activity of $2.4 billion in 2008.



Hydro-Québec Distribution is developing its system while ensuring service continuity.

Operations and Assets by Segment

(in millions of dollars)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities[1]	Intersegment eliminations and adjustments	Total
2008							
Revenue							
– External customers	2,066	52	10,540	–	32	27[2]	**12,717**
– Intersegment	4,931	2,733	62	2,416	1,156	11,298	**–**
Depreciation and amortization	777	611	828	5	127	(12)	**2,336**
Financial expenses	1,101	817	486	–	41	–	**2,445**
Income from continuing operations	2,137	481	421	–	(39)	12	**3,012**
Net income	2,137	481	421	–	90	12	**3,141**
Total assets	30,651	17,158	12,274	360	6,734	(403)	**66,774**
Investing activities							
Increase (decrease) in property, plant and equipment and intangible assets							
– Affecting cash	1,894	1,097	664	5	96	–	**3,756**
– Not affecting cash	(113)	17	4	–	–	–	**(92)**
2007							
Revenue							
– External customers	1,649	37	10,452	–	49	143[2]	**12,330**
– Intersegment	5,103	2,785	56	2,150	1,163	(11,257)	**–**
Depreciation and amortization	837	636	446	7	77	(12)	**1,991**
Financial expenses	1,180	817	484	–	31	–	**2,512**
Income from continuing operations	2,077	396	395	–	2	12	**2,882**
Net income	2,077	396	395	–	27	12	**2,907**
Total assets	29,509	16,707	11,833	263	6,814	(260)	**64,866**
Investing activities							
Increase in property, plant and equipment and intangible assets							
– Affecting cash	1,807	844	721	3	89	–	**3,464**
– Not affecting cash	41	14	35	–	–	–	**90**

1. This heading includes corporate units that support the divisions in the achievement of their business objectives. They include Groupe de la technologie, Groupe des affaires corporatives et du secrétariat général, Groupe des ressources humaines et des services partagés, Vice-présidence à la comptabilité et au contrôle and Vice-présidence au financement, à la trésorerie et à la caisse de retraite. The Centre de services partagés brings together internal services, including goods and services procurement, real estate management, and material and transportation service management.

2. Resales of excess supply by Hydro-Québec Distribution on outside markets are presented as offsets of electricity purchases rather than as revenue.

In all our activities, we promote environmentally responsible practices and the cleanest technologies.

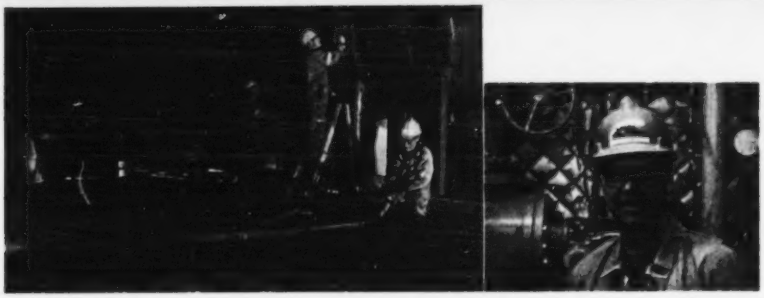
Dividends declared by Hydro-Québec for 2004–2008 total $9.2 billion, including $2,252 million for 2008.

Financial Ratios

	2004	2005	2006	2007	2008
FINANCIAL RATIOS					
Coverage ratios					
Interest coverage[1]	1.79	2.00	2.06	2.13	2.12
EBITDA interest coverage[2]	2.57	2.89	2.87	2.90	3.01
Liquidity ratios					
Net cash flow to fixed assets and intangible assets[3] (in %)	102.2	91.3	112.1	75.5	86.9
Self-financing[4] (in %)	65.9	51.2	69.9	61.9	44.9
Funds from operations to average total debt[5] (in %)	11.2	12.4	13.9	13.7	14.2
Profitability ratios					
Profit margin from continuing operations[6] (in %)	21.0	21.6	25.1	23.4	23.7
Return on equity[7] (in %)	15.4	13.3	20.6	15.0	15.4
Capital structure ratio					
Capitalization[8] (in %)	32.7	34.1	36.1	37.5	37.7
Dividends[9] (in millions of dollars)	1,350	1,126	2,342	2,095	2,252

Note: Certain comparative figures have been reclassified to reflect the presentation adopted in the current year.

1. Sum of operating income and net investment income divided by gross interest expense.
2. Sum of operating income before amortization and net investment income divided by gross interest expense.
3. Income from continuing operations before amortization, less write-offs and dividends paid, divided by investments in property, plant and equipment and intangible assets.
4. Cash flows from operating activities less dividends paid, divided by the sum of cash flows from investing activities — excluding net (acquisition) disposal of short-term investments — and repayment of long-term debt.
5. Income from continuing operations before amortization, capitalized financial expenses and non-controlling interest less write-offs, divided by the sum of long-term debt, perpetual debt, non-controlling interest, short-term borrowings, current portion of long-term debt and derivative instrument liabilities, less derivative instrument assets (average for the year).
6. Net income from continuing operations divided by revenues.
7. Net income divided by average equity less average accumulated other comprehensive income.
8. Equity divided by the sum of equity, long-term debt, perpetual debt, short-term borrowings, current portion of long-term debt and derivative instrument liabilities, less derivative instrument assets.
9. Dividends declared for a given year are paid the following year.



In 2008, Hydro-Québec Production invested $491 million to ensure the long-term operability of its facilities or boost their capacity.

Comparison of Electric Utilities in North America

Financial Data and Operating Statistics[1]

(Comparison in dollars of origin)

	Canadian utilities				American utilities	
For the year ended	Hydro-Québec Dec. 31, 2007 C$	British Columbia Hydro March 31, 2008 C$	Manitoba Hydro March 31, 2008 C$	Ontario Power Generation Dec. 31, 2007 C$	New York Power Authority Dec. 31, 2007 US$	Tennessee Valley Authority Sept. 30, 2007 US$
OWNERSHIP	Government of Québec	Government of British Columbia	Government of Manitoba	Government of Ontario	State of New York	Government of the United States
STRUCTURE	Integrated	Integrated	Integrated	Generation	Generation/ Transmission	Generation/ Transmission
OPERATING STATISTICS						
Sales (TWh)	**192.8**	105.1	31.6	105.1	43.0	174.8
• Domestic	**173.2**	53.3	21.0	not applicable	43.0	not applicable
• Export	**19.6**	51.8	10.6	not applicable	0.0	not applicable
Installed capacity (MW)	**35,647**	11,280	5,465	22,158	6,276	33,410
Output (TWh)	**162.1**	52.8	35.4	105.1	26.3	156.4
• Hydroelectric (%)	**97.2**	98.8	98.6	30.3	74.3	5.8
• Nuclear (%)	**2.7**	0.0	0.0	42.1	0.0	29.7
• Thermal (%)	**0.1**	1.2	1.4	27.6	25.7	64.5
Customer accounts (thousands)	**3,869**	1,767	783	not applicable	not applicable	not applicable
Total workforce	**23,069**	5,185	5,816	11,700	1,557	12,013
FINANCIAL DATA (in millions of dollars)						
Revenue	**12,330**	4,855	2,250	5,660	2,906	9,187
Operating income[2]	**5,394**	832	786	610	183	1,464
Net income	**2,907**	369	346	528	235	383
Investments[3]	**3,464**	1,068	827	724	225	1,668
Property, plant and equipment	**53,291**	10,691	8,912	12,777	3,773	24,828
Total assets	**64,866**	13,610	11,767	24,839	7,008	33,902
Long-term debt	**33,161**	7,046	7,217	3,446	1,893	21,099
Equity	**20,892**	1,921	2,127	6,807	2,268	2,980

1. Certain data have been adjusted to provide a standard basis for comparison.
2. Operating income for BC Hydro includes deferral accounts.
3. Property, plant and equipment and intangible assets.

In 2008, the average cost of a kilowatthour supplied by Hydro-Québec Production was 2.2¢—or the sum of the generating, procurement and sales costs divided by the net sales volume.

Comparative Index of Electricity Prices in 2008

Residential Customer Accounts at April 1, 2008 (Montréal = 100)
Monthly bill for a consumption of 1,000 kWh (taxes excluded)

Industrial Customer Accounts at April 1, 2008 (Montréal = 100)
Monthly bill (taxes excluded) for a demand of 10 MW, a consumption of 5,760 MWh and a load factor of 80%

Source: Hydro-Québec, *Comparison of Electricity Prices in Major North American Cities, April 1, 2008*.

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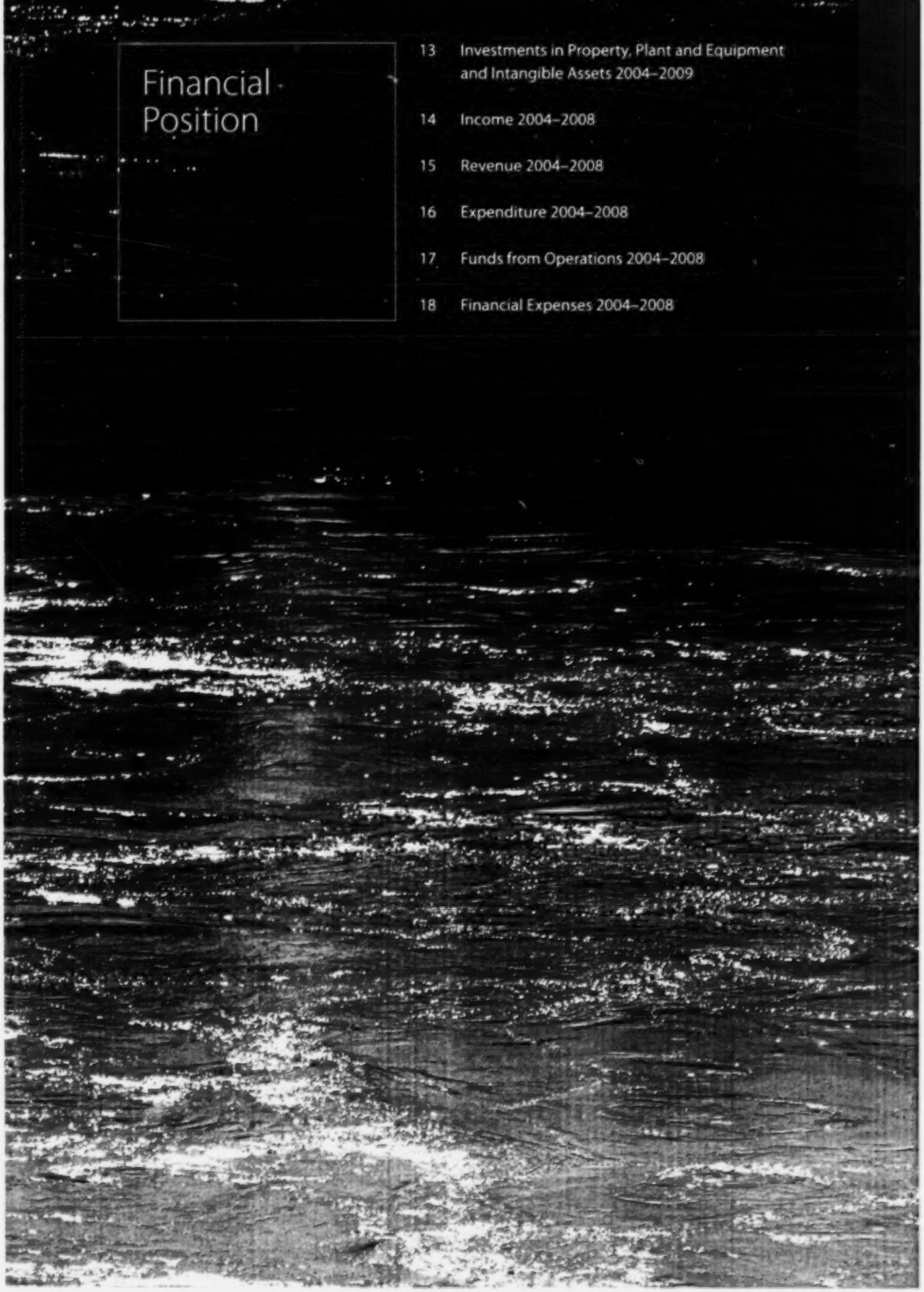
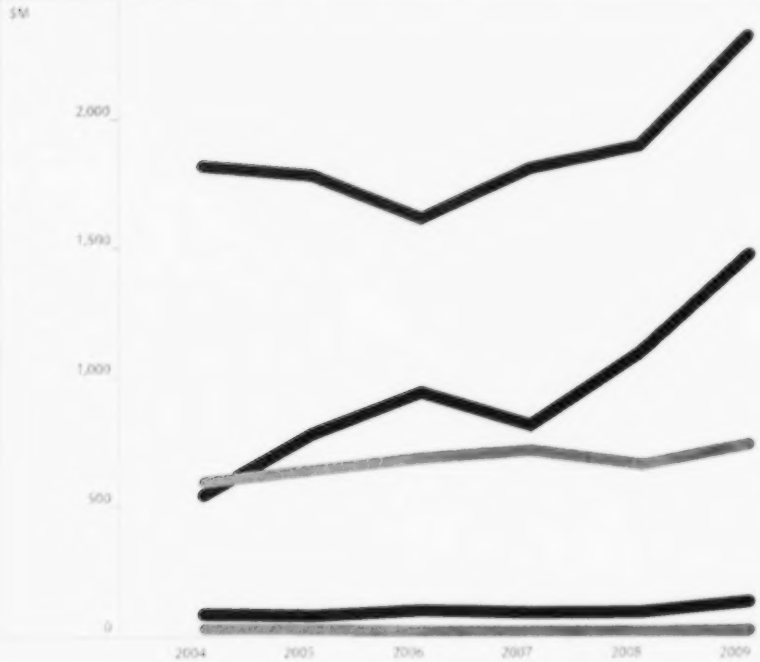


In 2008, Hydro-Québec Équipement and SEBJ were in charge of more than a thousand jobsites in Québec.

Investments in Property, Plant and Equipment and Intangible Assets 2004–2009

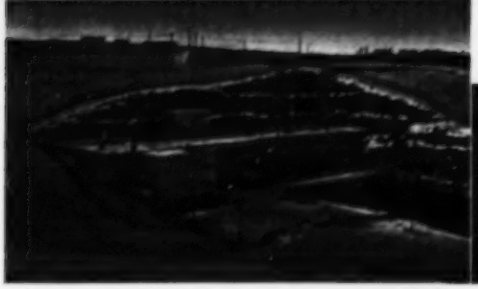
(affecting cash)



Hydro-Québec plans to invest $5.0 billion in 2009: $4.7 billion will be allocated to investments in property, plant and equipment and intangible assets and $303 million to Hydro-Québec Distribution's Energy Efficiency Plan (EEP). A substantial portion of these investments—60%—will be devoted to development and growth activities, while 40% will be used to finance work to ensure the long-term operability of our facilities.

						Forecast
■ Generation	1,820	1,780	1,615	1,807	1,894	2,325
■ Transmission	553	784	940	844	1,097	1,479
■ Distribution	601	645	690	721	664	743
■ Corporate and Other Activities[1]	86	78	99	89	96	134
■ Construction	11	6	4	3	5	6
Total	**3,071**	**3,293**	**3,348**	**3,464**	**3,756**	**4,687**

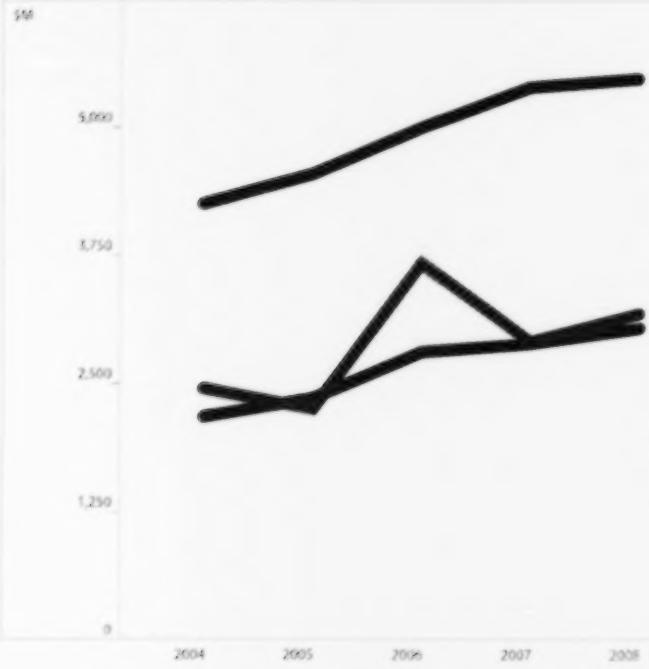
1. This heading includes corporate units that support the divisions in the achievement of their business objectives. They include Groupe de la technologie, Groupe des affaires corporatives et du secrétariat général, Groupe des ressources humaines et des services partagés, Vice-présidence à la comptabilité et au contrôle and Vice-présidence au financement, à la trésorerie et à la caisse de retraite. The Centre de services partagés brings together internal services, including goods and services procurement, real estate management, and material and transportation services management.



Eastmain-1 generating station, commissioned in 2006.

We invest about $100 million a year in activities directed by our research institute (IREQ).

Income 2004–2008



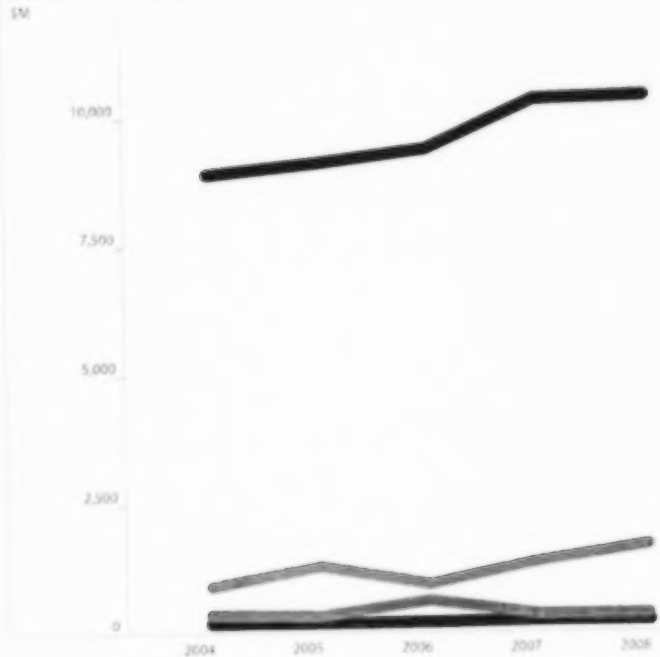
In 2009, Hydro-Quebec expects to earn net income of $2.7 billion entirely from continuing operations.

	2004	2005	2006	2007	2008
Operating income[1]	4,251	4,537	5,009	5,394	5,457
Income from continuing operations[2]	2,168	2,351	2,797	2,882	3,012
Net income	2,435	2,252	3,741	2,907	3,141

1. The excess of revenue over expenditure before financial expenses and discontinued operations.
2. The excess of revenue over expenditure (including financial expenses) before discontinued operations.

The first phase in the new interconnection with Ontario will come on stream in 2009.

Revenue 2004–2008



The 2008 growth in revenue from electricity sales is primarily the result of the April 1, 2007 and 2008 rate adjustments, which were partially offset by the effect of milder temperatures than in 2007 and a decrease in demand from industrial customers. The increase in revenue from electricity sales in markets outside Québec is mainly due to Hydro-Québec Production's higher export volume.

	2004	2005	2006	2007	2008
Electricity sales in Québec	8,922	9,121	9,402	10,368	10,445
Electricity sales outside Québec (short-term)	905	1,290	951	1,392	1,699
Electricity sales outside Québec (long-term)	179	174	198	225	220
Other revenue[1]	335	302	610	345	353
Total	**10,341**	**10,887**	**11,161**	**12,330**	**12,717**

1. Revenue from services related to the sale of electricity and from ancillary business activities.

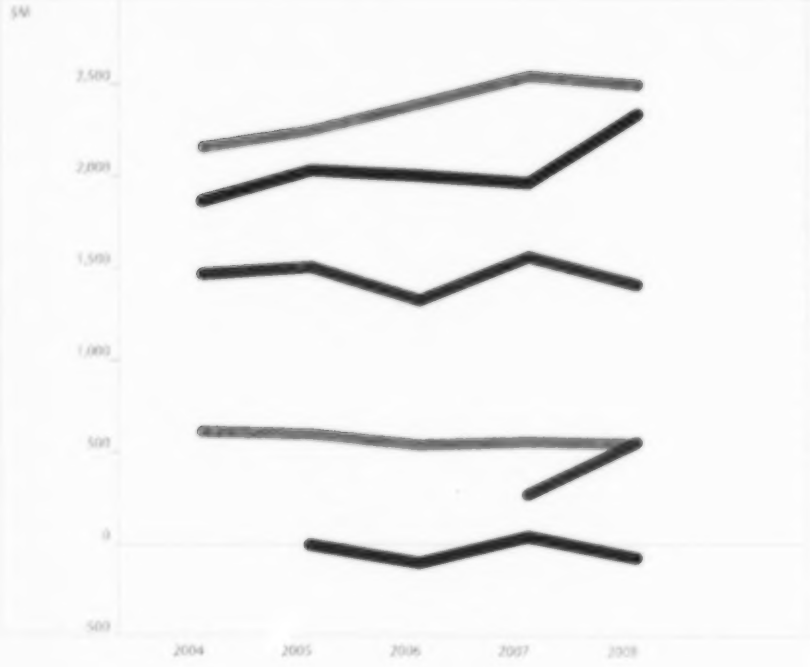
Breakdown of electricity sales revenue by customer category

	2008
Residential and farm	34.8%
Industrial	25.7%
General and institutional	21.7%
Other, including sales outside Québec	17.8%

Valve room at Lévis substation, where alternating current is converted to direct current.

Refitting under way at Outardes-3 generating station.

Expenditure 2004–2008

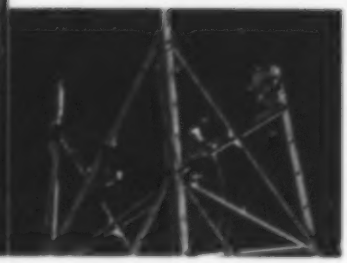


Total expenditure reached $7,260 million in 2008, up $324 million from 2007. The difference stems mainly from a $328-million increase in amortization expense for regulatory assets and liabilities arising from variances in Hydro-Québec Distribution's transmission and electricity procurement costs. In addition, electricity purchases made by this division in excess of the heritage pool decreased by $228 million. Capital tax decreased by $76 million, primarily because of a lower rate of taxation, while water-power royalties levied on Hydro-Québec Production rose by $285 million. It should be noted that in 2007, a transition year, the half-rate rule applied.

	2004	2005	2006	2007	2008
Operating expenses	2,154	2,245	2,389	2,541	2,497
Depreciation and amortization	1,862	2,023	2,007	1,991	2,336
Electricity and fuel purchases	1,464	1,496	1,315	1,555	1,406
Taxes	610	597	534	553	541
Water-power royalties[1]	–	–	–	267	552
Regulatory deferrals	–	(11)	(93)	29	(72)
Total	**6,090**	**6,350**	**6,152**	**6,936**	**7,260**

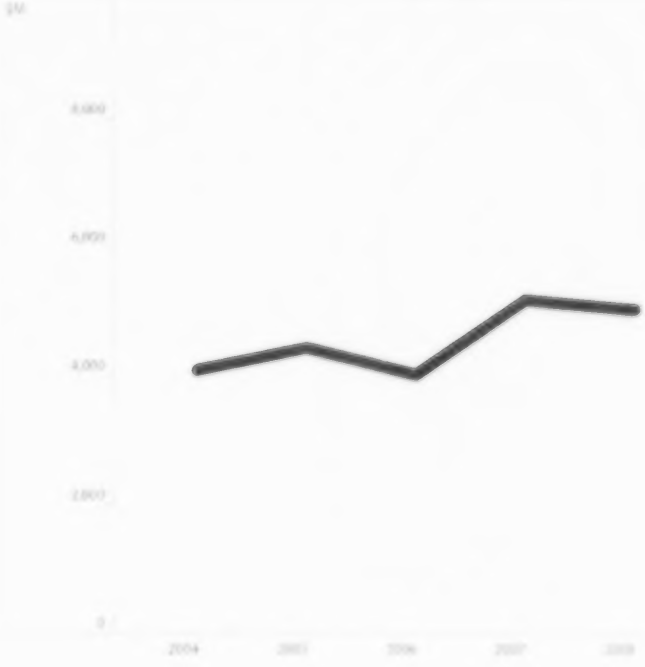
1. As of 2007, Hydro-Québec has been required to pay water-power royalties under the terms of the Watercourses Act. For 2007, a transition year, the half-rate rule applied.

Carillon generating station



A 735-kV line under construction

Funds from Operations 2004–2008



Funds from operations totaled $5.0 billion, a level comparable to 2007. Among other things, this cash was used to pay the dividends of $2,095 million declared for 2007 and to finance a large part of our investments. The size of this capital program reflects our continued involvement in major projects in the Generation and Transmission sectors, such as the Eastmain-1-A/Sarcelle/Rupert hydroelectric development and the 1,250-MW interconnection with Ontario.

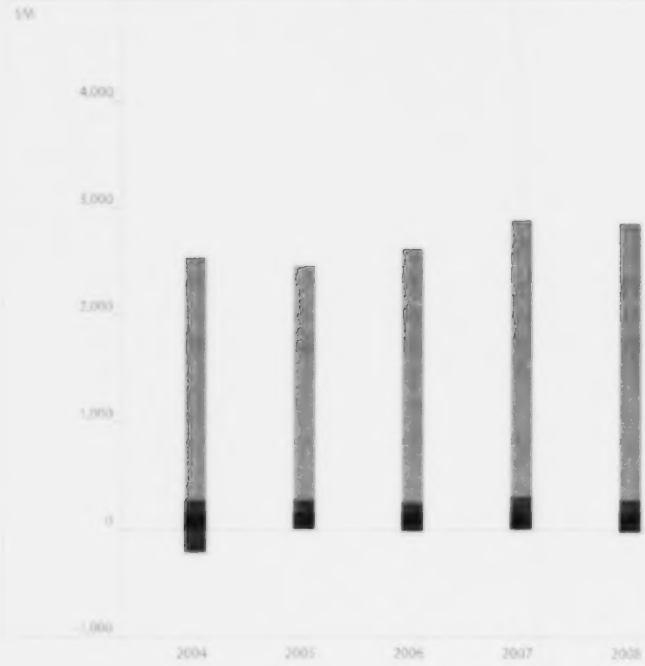
	2004	2005	2006	2007	2008
■ Funds from operations	4,017	4,399	4,005	5,159	5,015

1 Dividend cash outflows from operating activities

Chute-Allard hydropower development.

Drilling the transfer tunnel at the Rupert diversion site.

Financial Expenses 2004–2008



Financial expenses totaled $2,445 million, a $67-million reduction from 2007. The difference is attributable in part to higher capitalized financial expenses as a result of the increase in the average value of capital projects under construction, in particular due to continued work at the Eastmain-1-A/Sarcelle/Rupert jobsite. It also stems from the effect of converting U.S. dollar-denominated working capital into Canadian dollars, given the depreciation of the Canadian dollar during the last quarter of 2008.

■	Interest on debt securities	2,266	2,188	2,367	2,584	2,585
■	Amortization of debt premiums, discounts and issue expenses	115	117	99	111	111
■	Net exchange (gain) loss	(218)	(1)	(21)	18	(25)
■	Loan guarantee fees	161	155	158	169	167
Less						
	Capitalized financial expenses	226	249	312	283	306
	Net investment income	15	24	79	87	87
	Total	**2,083**	**2,186**	**2,212**	**2,512**	**2,445**

Financing

20 Financing Objectives and Strategies and Debt Management

21 Breakdown of Debt by Repayment Currency 2004–2009

22 Breakdown of Total Debt by Fixed and Floating Rate 2004–2008

Evolution of Components of Total Debt 2004–2008

23 Financing Needs 2004–2008

24 Preauthorized Financing

25 Debt Maturities 2009–2018

26 Average Maturity of Debt 2004–2008

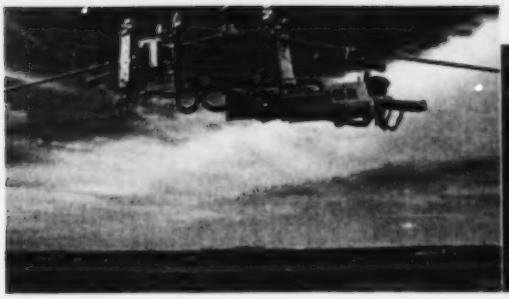
27 Guarantee of Hydro-Québec's Debt

28 Credit Ratings

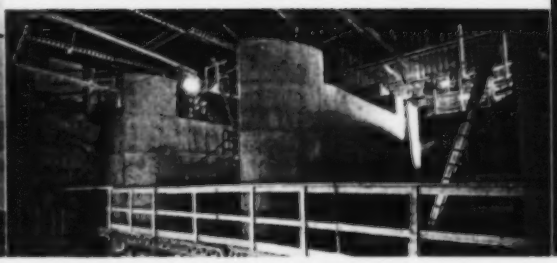
Refurbishment at Première-Chute generating station.

Financing Objectives and Strategies and Debt Management

Objectives	Strategies
1. Maintain the presence and impact of Hydro-Québec on capital markets	• Plan bond issuance in order to establish liquid benchmarks • Stagger debt maturities in order to maintain the annual financing program at a stable level • Focus on strategically important capital markets, in particular, the Canadian bond market
2. Diversify Hydro-Québec's funding sources while minimizing foreign exchange risk	• Maintain access to foreign capital markets, particularly the U.S. dollar market • Use swaps to hedge financing in foreign currencies • Secure financing in the lowest-cost market
3. Manage Hydro-Québec's debt effectively	• Redeem debt prior to maturity whenever possible, if such operations allow Hydro-Québec to reduce the cost of its debt

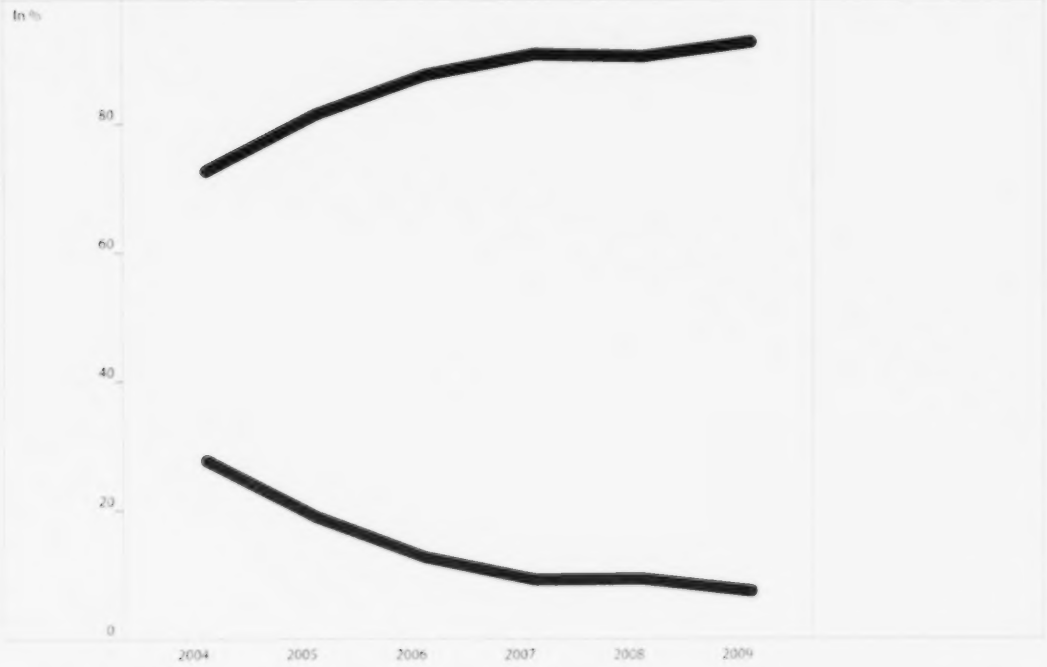


The LineScout, the first robot of its kind in the world, was developed by researchers at IREQ for use in transmission line maintenance.



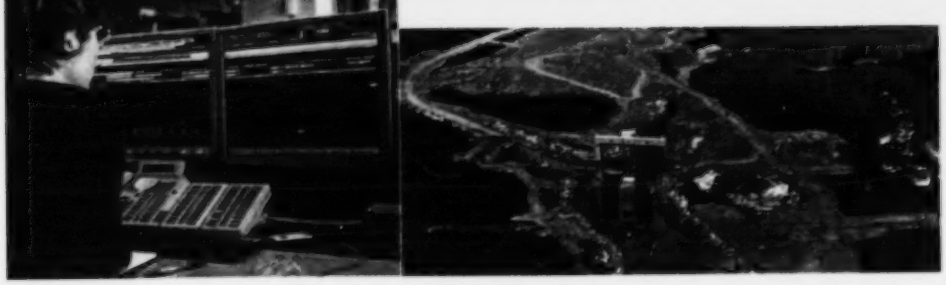
Hydro-Québec Production's 2008 investments totaled $1,894 million, including $1,403 million for development projects.

Breakdown of Debt by Repayment Currency 2004–2009[1]



	2004	2005	2006	2007	2008	Forecast 2009
■ Canadian dollars (%)	72.6	81.3	87.5	90.8	90.5	92.7
■ U.S. dollars (%)	27.4	18.7	12.5	9.2	9.5	7.3

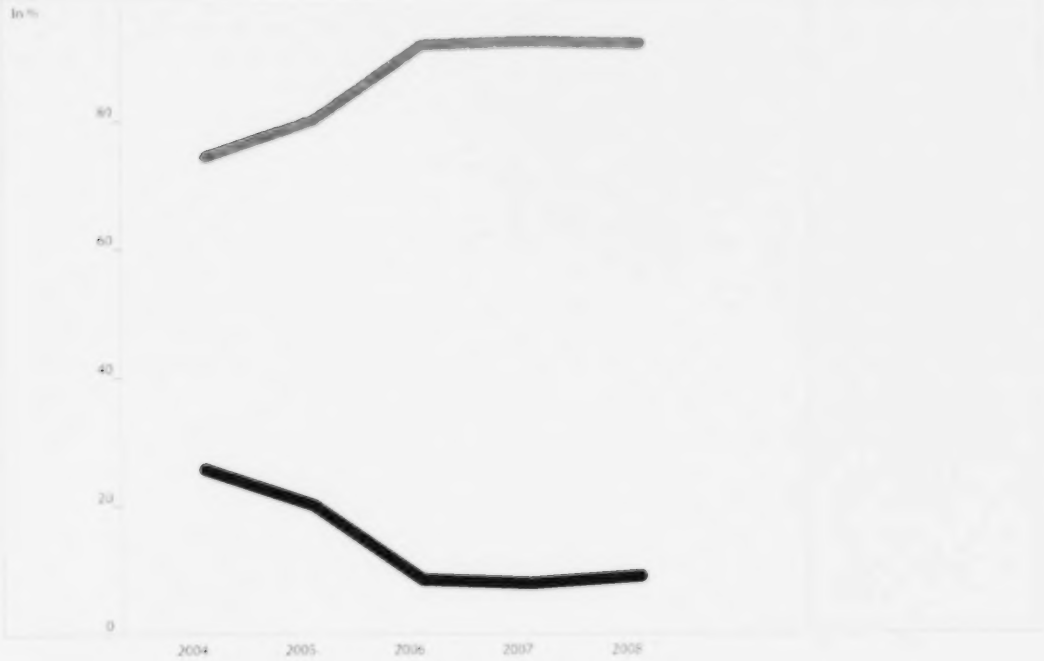
1. Debt including perpetual debt, swaps and sinking funds of Hydro-Québec, excluding subsidiaries and holdings. The debt, swaps and sinking funds are evaluated at par value and translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date.



Return on equity amounted to 15.4% in 2008—evidence of our strong financial performance.

Construction of Rupert spillway and dam, in the Baie-James region.

Breakdown of Total Debt by Fixed and Floating Rate 2004–2008[1]



	2004	2005	2006	2007	2008
■ Fixed-rate debt (%)	74.3	79.9	91.8	92.2	91.1
■ Floating-rate debt (%)	25.7	20.1	8.2	7.8	8.9[2]

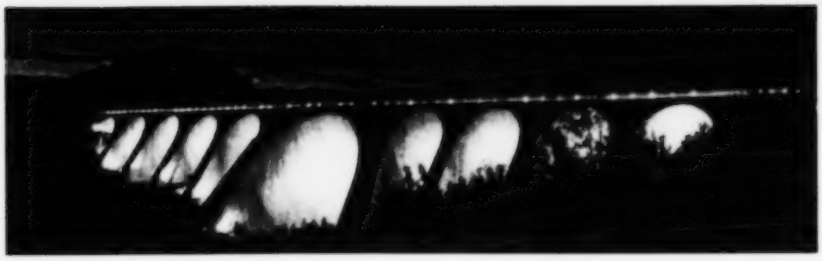
1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings. The debt is translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date.
2. Excluding swaps related to credit risk mitigation.

Evolution of Components of Total Debt 2004–2008[1]

(in millions of dollars)

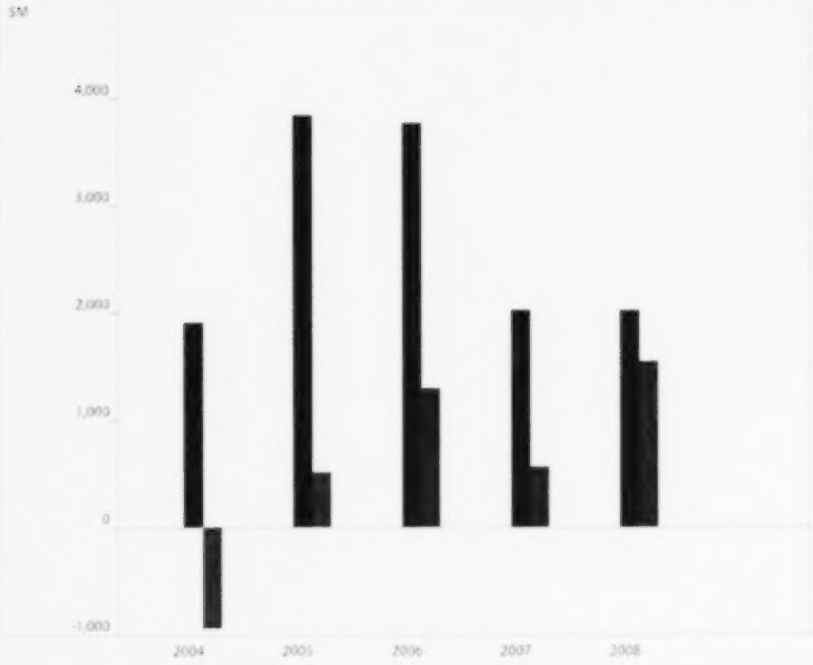
	2004	2005	2006	2007	2008[2]
Long-term debt	30,178	29,859	32,992	33,135	35,261
Current portion of long-term debt	1,657	2,636	1,061	1,085	767
Perpetual debt	391	379	337	286	355
Total debt	**32,226**	**32,874**	**34,390**	**34,506**	**36,383**

1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings. The preceding table shows the par value of the debt translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date, with the exception of 2007 and 2008. Since January 1, 2007, the long-term debt has been shown at the amortized cost, except for deep discount and high premium bonds, which were already shown this way prior to that date.
2. Exchange rate: C$/US$ 1.2246.



Daniel-Johnson dam.

Financing Needs 2004–2008[1]

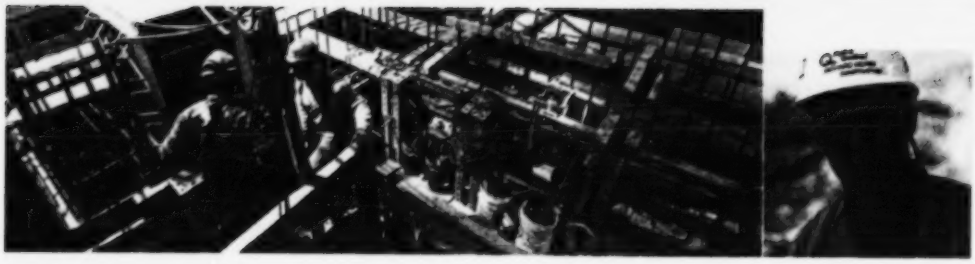


Hydro-Québec manages its credit risk using a number of methods, including the adoption of credit limits for each counterparty and the implementation of risk mitigation agreements. In 2008, changes in the market value of the financial instruments subject to these agreements gave rise to net cash inflows of $2.3 billion.

Our 2009 borrowing program is approximately $2.1 billion.

	2004	2005	2006	2007	2008
■ Gross borrowing[2]	1,916	3,855	3,781	2,028	2,029
■ Net borrowing (or repayment)	(979)	515	1,298	563	1,551

1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings.
2. Excluding net inflows and outflows relating to credit risk management.



At the summer 2008 construction peak, nearly 3,500 people were employed on the Eastmain-1-A/Sarcelle/Rupert site.

Preauthorized Financing

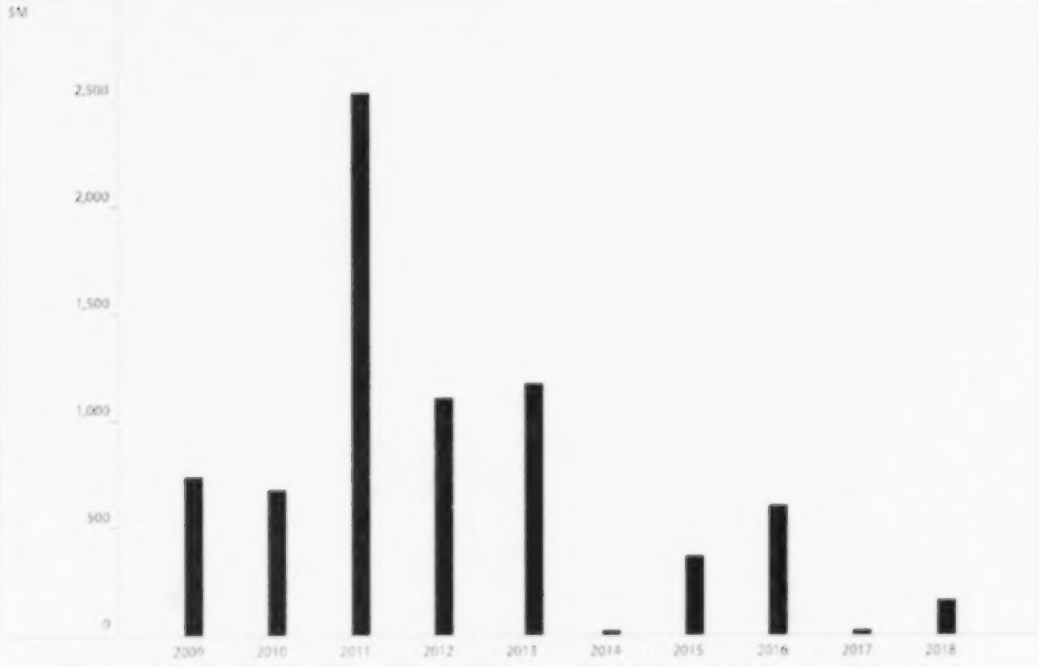
Type of financing	Volume authorized	Market	Maturity	Outstanding at December 31, 2008
Lines of credit	US$350 million or C$350 million			
	C$40 million US$110 million			
Standby line of credit[1]	US$2 billion		US$360 million in 2012 US$1,640 million in 2013	
Commercial paper[1]	US$2,250 million or C$ equivalent	United States or Canada	Max. 364 days Max. 365 days	C$91 million
Medium-term notes[1]	US$3,000 million or equivalent in other currencies	United States	9 months or longer	US$440 million
	C$16,000 million or US$ equivalent	Canada	1 year or longer	C$10,986 million

1. Guaranteed by the Quebec government.

Toe of an arch protected with a thermal shelter at Daniel-Johnson dam.

Retaining skilled workers in all fields of electricity is a major factor in achieving our business objectives.

Debt Maturities 2009–2018

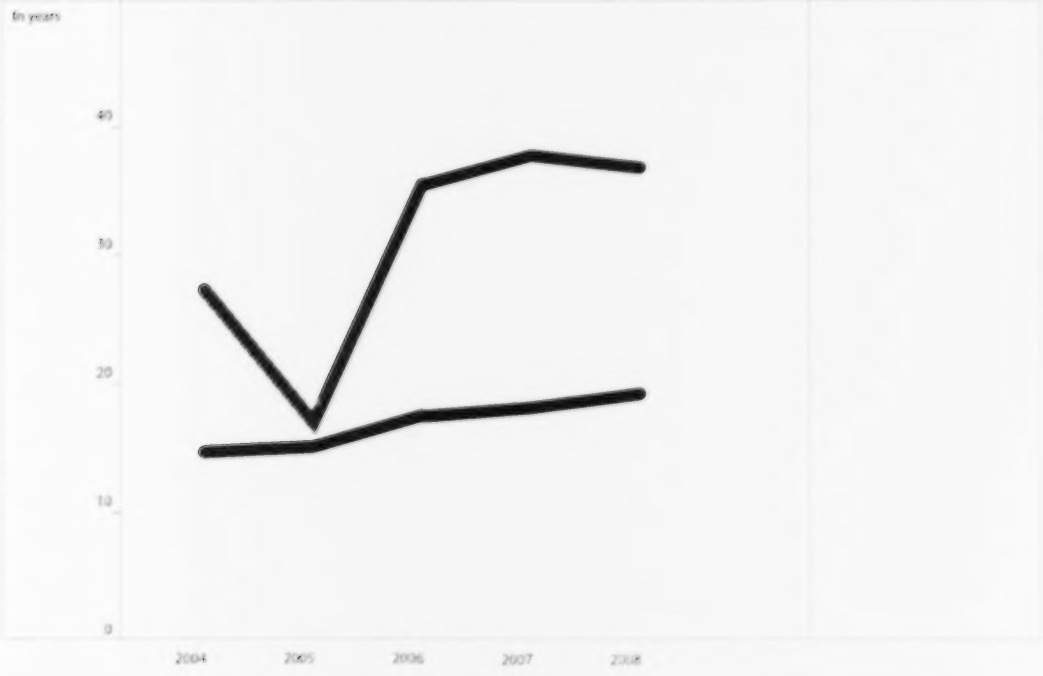


	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
■ Debt Maturities	734	675	2,515	1,100	1,166	20	366	601	22	159

1 The above graph shows outflows of funds related to debt maturities for the next 10 years, representing the par value of the debt. In the financial statements, the long-term debt has been shown at the amortized cost since January 1, 2007, except for deep discount and high premium bonds, which were already shown this way prior to that date.

Funds from operations totaled $5.0 billion in 2008.

Average Maturity of Debt 2004–2008[1]



	2004	2005	2006	2007	2008
Average maturity of borrowings for the year	27.3	16.9	35.4	37.6	36.8
Average maturity of debt	14.5	14.8	17.3	18.0	19.1

1. The analysis deals with the financing activities of Hydro-Québec, excluding its subsidiaries and holdings.

The 2008–2009 winter peak load—a record 37,230 MW—occurred on January 16, 2009 at 8 a.m.

The Rupert spillway

Guarantee of Hydro-Québec's Debt

Hydro-Québec's long-term debt in 2008 includes $34,881 million in debentures and medium-term notes that are guaranteed unconditionally and irrevocably by the Québec government. Short-term borrowing programs, such as commercial paper and standby lines of credit, are also guaranteed by the government.

Certain private investments and capital leases, totaling $430 million, are not guaranteed by the Québec government.

Debentures 2008–2009

At January 31, 2009

Type	Issue Date	Series	Coupon (%)	Maturity	Amount (C$M)	Currency	Remarks
CA	January 29, 2009	JN	5.000	February 15, 2050	500	CAD	Additional tranche of Series JN
CA	January 15, 2009	JN	5.000	February 15, 2050	500	CAD	
CA	September 2, 2008	JM	5.000	February 15, 2045	500	CAD	Additional tranche of Series JM
CA	May 16, 2008	JM	5.000	February 15, 2045	500	CAD	Additional tranche of Series JM
CA	April 25, 2008	JM	5.000	February 15, 2045	500	CAD	Additional tranche of Series JM
CA	February 19, 2008	JM	5.000	February 15, 2045	500	CAD	Additional tranche of Series JM

In 2008, net exports by Hydro-Québec Production accounted for only 8% of sales volume, but generated 32% of income from continuing operations.

Credit Ratings

		Long-term debt	Commercial paper
2008	Moody's	Aa2 stable	P-1
	Standard and Poor's	A+	A-1+
	Fitch Ratings	AA- positive	F1+
	Dominion Bond Rating Service	A (high) stable	R-1 (middle)
2007	Moody's	Aa2 stable	P-1
	Standard and Poor's	A+	A-1+
	Fitch Ratings	AA- stable	F1+
	Dominion Bond Rating Service	A (high) stable	R-1 (middle)

Excerpts from Credit Rating Agency Analyses

"HQ's ratings are heavily supported by the unconditional guarantee of Quebec Province. In addition to the guarantee, the company's stand-alone credit strength is derived from its quasi-monopoly position in the province, solid financial performance consistent with that of other municipal electricity providers in the 'AA-' category, cost competitive fleet of mostly hydroelectric generating assets, and dispatch flexibility provided by its enormous reservoirs. HQ's extensive reservoir system is unlike any other utility in the North America. The tremendous storage capability of the reservoirs provides a unique dispatching flexibility, allowing HQ to optimize hydropower sales to neighboring utilities during their peak usage and electricity pricing periods. HQ then purchases power from these same regions during off-peak periods, when electricity prices are lower, to conserve HQ water."

Fitch Ratings, Press Release, January 28, 2008

"Moody's believes that HQ has considerable liquidity resources, not only in the form of its commercial paper program backed by committed bank facilities but also in the form of the flexibility it has in the timing of its capital expenditures and its ability to draw down a portion of the energy stored in its reservoirs if circumstances warrant."

Moody's Credit Opinion dated June 17, 2008

Issues

30 Risk Management

32 Hydro-Québec and Sustainable Development

33 Romaine Complex

34 Generating Facilities 2008

35 Refurbishment of Gentilly-2 Nuclear Generating Station

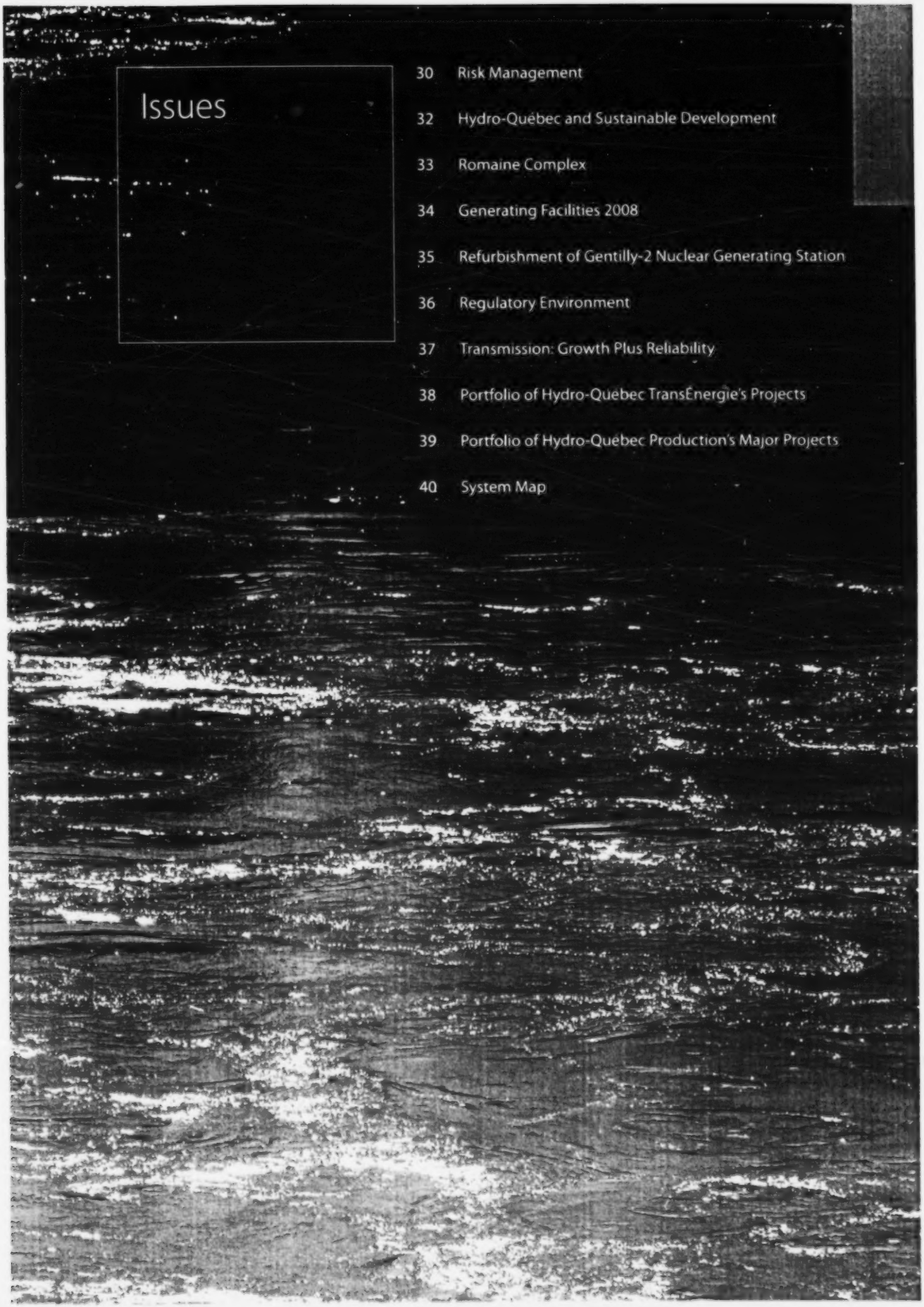
36 Regulatory Environment

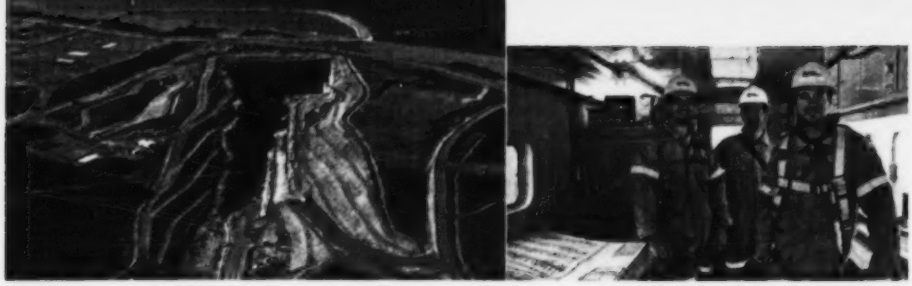
37 Transmission: Growth Plus Reliability

38 Portfolio of Hydro-Québec TransÉnergie's Projects

39 Portfolio of Hydro-Québec Production's Major Projects

40 System Map





Hydro-Québec Équipement and SEBJ design, engineer and supervise construction and refurbishment projects according to the needs of their customers, Hydro-Québec Production and Hydro-Québec TransÉnergie.

Risk Management

Integrated enterprise risk management has been part of Hydro-Québec's standard business practices for several years. It is supported by various control, communication and assessment mechanisms that enable the company to monitor risk evolution on a dynamic basis. Each division or corporate unit must determine and assess its main risks, and then apply mitigation measures to ensure that residual risks are at a level acceptable to Hydro-Québec. This exercise results in a consolidated portfolio of enterprise risks which is presented annually to the Board of Directors.

Risk	Overview of Mitigation Measures
FINANCIAL RISKS	
Volatility of interest rates, exchange rates and aluminum prices	• Short-term: active integrated management to limit impacts on the company's results • Medium- and long-term: mitigation through certain compensatory factors such as debts in U.S. dollars as a hedge against sales in this currency
Credit risk	• Proactive approach based on implementing and monitoring of limits and frameworks for risk concentration and level of counterparty exposure: – transactions with counterparties with a high credit rating – agreements to limit the market value of exposure to counterparties' credit risk
OPERATIONAL RISKS	
Generation	
Runoff	• Efficient management of water resources, allowing Hydro-Québec Production to meet all its commitments • Maintenance of an adequate margin between commitments and generating capacity • Multiyear management of energy reserves (see graph below)
Risk related to marketing activities (runoff, volatility of electricity prices, unavailability of generating and transmission equipment)	• Integrated evaluation of components of risk related to Hydro-Québec Production's marketing activities • Monitoring of limits, controls and daily reports by an independent team of specialists • Ongoing monitoring of trends in wholesale markets and use of derivative hedging instruments • Generating and transmission equipment maintenance and upgrade programs to maximize availability

Energy Reserves
1992–2009

By running underneath a lake, the transfer tunnel in the Rupert diversion will greatly reduce the land area flooded.

OPERATIONAL RISKS (continued)

Transmission

Long-term operability of assets and continuity of transmission service	• Application of NERC[1] and NPCC[2] reliability criteria • Designation of Hydro-Québec TransÉnergie's Direction du contrôle des mouvements d'énergie (system control unit), in 2007, as Reliability Coordinator for Québec • Strategy of long-term operability of transmission assets, for example, through measures to maintain and reinforce transmission facilities and extend their service life • Optimal management of annual peak load

1. North American Electric Reliability Corporation
2. Northeast Power Coordinating Council

Distribution

Long-term operability of system and service quality	• Compliance with applicable standards for overhead and underground systems • Strategy for asset renewal • Program of system maintenance and vegetation control
Fluctuations in demand (under normal weather conditions) due to current economic situation	• Fine-tuning of method for forecasting short-term demand

CONSTRUCTION PROJECTS

Impact of demand for skilled labor and market-specific inflation	• Strategies to mitigate impacts on procurement and on completion of construction projects • Strict management to contain costs while meeting deadlines and high quality and safety standards

CORPORATE AND OTHER ACTIVITIES

Environmental protection and conservation	• ISO 14001–certified environmental management system • Management of environmental issues and integration of environmental concerns into all the company's ongoing activities
Information security	• Regular assessments of information system defences against intrusions • Information and communications technologies security program, antivirus expertise centre, Internet filtering devices, monitoring of systems, access and identity management • Incident and vulnerability management plan
Service continuity	• Corporate emergency response plan ensuring rapid restoration of electricity service in case of an exceptional event

Our hydroelectric development projects must meet three criteria before they can proceed: they must be profitable, environmentally acceptable and favorably received by local communities.

Hydro-Québec and Sustainable Development

Sustainable development remains a matter of critical importance to Hydro-Québec. This is reflected in all facets of the company's activities as well as in its commitment to emphasize renewable energies.

Here is an overview of key sustainability activities carried out in 2008:

Reducing greenhouse gas (GHG) emissions

- Electricity produced by Hydro-Québec generates 43 times less CO_2, 38 times less SO_2 and 20 times less NO_x than the average for neighboring provinces and states in Canada and the U.S.
- We have cut CO_2 emissions from our vehicle fleet by 2,423 tonnes since 2005, even though the number of vehicles has increased.
- At Eastmain 1 reservoir (Nord-du-Québec), GHG emissions totaled 214,000 tonnes of CO_2 equivalent: 44% less than in 2007 and 76.4% less than in 2006. Three years after reservoir impoundment, CO_2 and methane emissions are comparable to those from natural aquatic environments.

Emphasizing renewable energies

- Romaine complex: we filed the environmental impact statement and a supplement to the study.
- The Régie de l'énergie approved 15 contracts signed by Hydro-Québec further to the 2005 tender call for the supply of 2,000 MW of wind power generated in Québec. Deliveries will run from 2011 to 2015.
- We purchased 271 GWh of biomass output from the Kruger (19 MW) and Bowater (20 MW) cogeneration plants.

Promoting energy efficiency

- For the fifth year in a row, we surpassed our Energy Efficiency Plan objectives, with savings of 1.1 TWh. Total savings achieved now amount to 76% of the 4.5 TWh targeted for 2009. The targets for 2010 and 2015 are 5.8 TWh and 11.0 TWh, respectively.

Preserving heritage in host communities

- Near the site of the future Kuujjuaq generating station (Nunavik), digs conducted by an Inuit company uncovered remains of the Saqqaq culture, about which little has been documented and which could date back nearly 4,000 years.

Supporting community and culture

- Through its donations and sponsorships, Hydro-Québec supports initiatives of social, cultural, environmental and economic interest. In 2008, the company granted $25.9 million in donations and sponsorships.

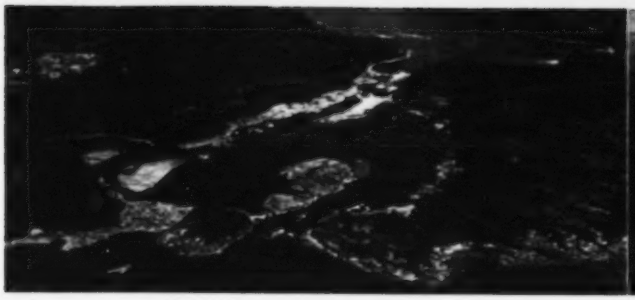
Stimulating regional economies

- For 2004–2020, regional economic spinoffs from Hydro-Québec's main generating projects in progress or under study should total over $2.7 billion.

Comparison of Hydro-Québec's Air Emissions versus the Regional Average[1]
(Emission factors: metric tons/TWh)

1. Regional average for electric utilities in the six New England states, the State of New York (2005), Ontario (2007) and New Brunswick (2006–2007). Data include emissions generated by Hydro-Québec facilities and electricity purchases.

Sources: Emissions & Generation Resource Integrated Database (eGRID 2007), version 1.1, January 2009, U.S. EPA; Sustainable Development 2007 Report, Ontario Power Generation; New Brunswick Power Corporation 2006–2007 Annual Report; New Brunswick Power Corporation Environmental Performance Report 2006.



The Rivière Romaine.

Havre-Saint-Pierre.

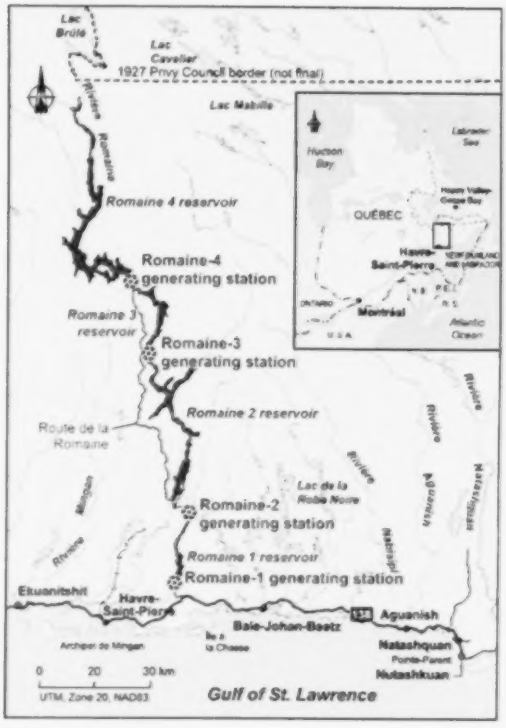
Romaine Complex

The planned Romaine hydropower complex, with a total capacity of 1,550 MW, is to be built on the Romaine, north of Havre-Saint-Pierre, on the north shore of the St. Lawrence River. Construction on what will be Canada's largest infrastructure project should begin in 2009 and conclude in 2020.

Project description

- Planned investment: $6.5 billion
- Installed capacity: 1,550 MW
- Average annual output: 8 TWh
- Four hydroelectric generating stations, each comprising a rockfill dam, a powerhouse equipped with two generating units and a spillway
- 150-km road to be built
- Project carried out in partnership with local communities and with respect for the environment
- The environmental studies, mitigation measures and follow-up will cost an estimated $200 million
- An extensive environmental follow-up program will be carried out until 2040

Project Overview



Mercier generating station.

Manic-2 generating station.

Generating Facilities 2008

	Commissioning date	Capacity
		(in MW)
Hydroelectric generating stations[1]		
Robert-Bourassa	1979–1981	5,616
La Grande-4	1984–1986	2,779
La Grande-3	1982–1984	2,417
La Grande-2-A	1991–1992	2,106
Beauharnois	1932 and 1961	1,903
Manic-5	1970–1971	1,596
La Grande-1	1994–1995	1,436
Manic-3	1975–1976	1,244
Bersimis-1	1956–1959	1,178
Manic-2	1965–1967	1,123
Manic-5-PA	1989–1990	1,064
Outardes-3	1969	1,026
Other (47 generating stations rated less than 1,000 MW, including Lac-Robertson owned by Hydro-Québec Distribution)	1910–2008	10,630
		34,118
Nuclear generating station		
Gentilly-2	1983	**675**
Thermal generating stations (conventional)		
Tracy (steam)	1964–1968	660
Bécancour, La Citière and Cadillac (gas-turbine)	1976–1993	852
Other (23 diesel plants)[2]	1946–2001	122
		1,634
Wind farm		
Saint-Ulric (3 wind turbines)	2001	**2**
Installed capacity of Hydro-Québec's generating fleet		**36,429**
Other sources of supply		
Churchill Falls generating station – Churchill Falls (Labrador) Corporation Limited[3]		5,428
Eight privately owned wind farms[4]		530
Agreements with other independent power producers[5]		1,277
		7,235

Commissionings in recent years

	Commissioning date	Capacity
		(in MW)
Hydroelectric generating stations[1]		
Rocher-de-Grand-Mère	2004	230
Sainte-Marguerite-3	2003–2004	884
Toulnustouc	2005	526
Eastmain-1	2006	507
Mercier	2007	51
Péribonka (2 generating units in 2008)	2007–2008	405
Chute-Allard (3 generating units in 2008)	2008	31
Rapides-des-Coeurs (1 generating unit in 2008)	2008	13
Total	2004–2008	**2,647**

1. The installed capacity shown for the generating stations reflects winter turbine operating conditions (water temperature at 5 °C).
2. Owned and operated by Hydro-Québec Distribution.
3. Hydro-Québec has access to almost all the output.
4. Hydro-Québec purchases all the output.
5. Hydro-Québec has access to this output.

Gentilly-2 nuclear generating station.

Refurbishment of Gentilly-2 Nuclear Generating Station

Nuclear power is a reliable, efficient and safe option for meeting energy needs without creating greenhouse gas emissions.

Gentilly-2 generating station

- Commissioned in 1983
- Installed capacity: 675 MW, equivalent to 2% of Hydro-Québec's entire fleet capacity
- Supplies nearly 5 TWh of energy per year, equivalent to the consumption of more than 270,000 residential customers
- Cost of refurbishment project: $1.9 billion
- Service life after refurbishment: until 2040

Generating station refurbishment

- *Main work (2011–2012)*
  - Removal of reactor fuel and lay-up of station systems
  - Replacement of reactor components
  - Replacement of station control computers
  - Work on turbine generator and related systems
  - Design improvements and refurbishment of several nuclear systems in compliance with applicable regulations
- *Expertise*
  - Environmental impact assessment approved by federal and provincial regulatory authorities (Canadian Nuclear Safety Commission and Québec's Ministère du Développement durable, de l'Environnement et des Parcs)
  - Main supplier for activities related to reactor and reactor systems: Atomic Energy of Canada Limited (AECL)
  - Supplier for activities related to turbine and generator: GE (General Electric)
  - Project management: Hydro-Québec Équipement
  - Participation, since 2006, in the refurbishment of New Brunswick's Point Lepreau nuclear generating station, which shares many characteristics with Gentilly-2
  - Third refurbishment project involving a CANDU 6 nuclear power reactor, after Point Lepreau in New Brunswick (under way) and Wolsong 1 in South Korea (scheduled for refurbishment in 2009 and 2010)

Construction of radioactive waste management facilities

- Goal: ensure safe, efficient management of solid radioactive waste produced by the plant's operation and refurbishment. The construction will proceed in four phases.
- **Phase 1** will enable Gentilly-2 to meet the plant's current operating requirements in terms of low- and medium-activity waste storage.
- **Phase 2** will cover storage requirements for waste resulting from the plant's refurbishment.
- **Phases 3 and 4** will cover the plant's ongoing requirements until the end of its service life.

Refurbishment schedule

Design	
Draft-design studies	2001–2008
Engineering and procurement	2008–2011
Gentilly-2 generating station	
Refurbishment outage	2011–2012
Continued operation	Until 2040
Construction of waste management facilities	
Phase 1	2007–2008
Phase 2	2009–2010
Phase 3	According to operating requirements
Phase 4	2024–2042

Hydro-Québec TransÉnergie markets system capacity and manages power flows throughout Québec.

Hydro-Québec Distribution manages procurement so to ensure a reliable supply of electricity at the lowest possible cost.

Regulatory Environment

The Régie de l'énergie regulates electricity transmission and distribution activities in Québec.

Generation is not regulated by the Régie. However, under the *Act respecting the Régie de l'énergie*, Hydro-Québec Production is required to supply Hydro-Québec Distribution with a heritage pool of 165 TWh at an average price of 2.79¢/kWh.

Key points of regulated activities

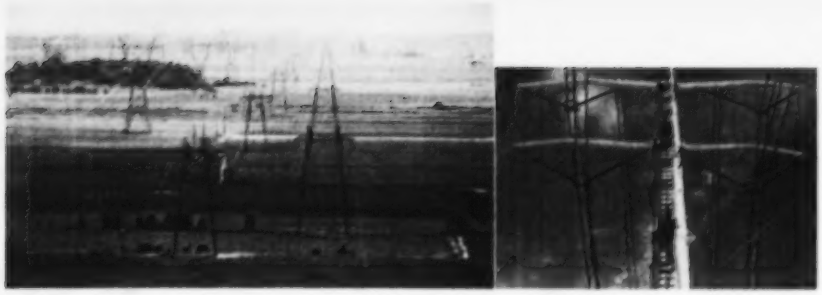
	Hydro-Québec Distribution (HQD)	Hydro-Québec TransÉnergie (HQT)
Regulatory regime	Cost-based	Cost-based
Rate adjustment	In March 2009, the Régie approved a 1.2% across-the-board rate adjustment effective April 1, 2009.	2008 $70.82/kW/year 2009 $72.00/kW/year
Assumed capitalization	35% equity 65% debt	30% equity 70% debt
Authorized return on equity 2008 2009	 7.74% 6.985%	 7.847% 7.630%

Effects of rate regulation on the consolidated financial statements

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the decisions of the Régie de l'énergie.

These decisions affect the timing of the recognition of certain transactions in the consolidated operations, resulting in the recognition of regulatory assets and liabilities which Hydro-Québec considers it is likely to recover or settle subsequently through the rate-setting process. Note 3, Effects of Rate Regulation on the Consolidated Financial Statements, presented on page 84 of Hydro-Québec's *Annual Report 2008*, states the net carrying value of these assets and liabilities as at December 31, 2008.

If Hydro-Québec's transmission and distribution operations in Québec were not regulated, the costs would generally be recognized in the year's results and net income would be reduced by $136 million for 2008 ($199 million for 2007).



In 2008, Hydro-Québec TransÉnergie invested $19 million in developing or adapting innovations in order to optimize system performance and ensure long-term operability.

Transmission: Growth Plus Reliability

Hydro-Québec TransÉnergie operates the most extensive transmission system in North America.

- Hydro-Québec TransÉnergie carefully maintains its system of 33,058 km of lines and 510 substations in order to ensure its constant reliability.
- Through its 19 interconnections, Hydro-Québec TransÉnergie carries out interchanges with the Brookfield and Alcan systems in Québec, with neighboring provinces (Newfoundland and Labrador, New Brunswick and Ontario) and with the U.S. Northeast. Once the new interconnection with Ontario is commissioned in summer 2009, maximum interchange capacity will total 11,920 MW in import mode and 9,625 MW in export mode.
- In compliance with North American regulatory provisions, Hydro-Québec TransÉnergie ensures non-discriminatory treatment of wholesalers who wish to access the transmission system.

Neighboring system	Import mode (MW)	Export mode (MW)
Newfoundland and Labrador	5,200	0
New Brunswick	785	1,080
Ontario	1,970	2,705
New England	1,870	2,275
New York	1,100	2,000
Lièvre River Power[1] (Brookfield)	345	115
Alcan[1]	650	1,450

1. Interconnection with systems within Québec.

A system undergoing significant development

Hydro-Québec TransÉnergie invests substantial sums in developing the transmission system, improving reliability and ensuring the long-term operability of its assets.

- In 2008, investments totaling $559 million enabled Hydro-Québec TransÉnergie to bring 950 MW onto the grid through the addition of new generating facilities such as Péribonka, Rapides-des-Cœurs and Chute-Allard. Close to $95 million went to connecting the eight wind farms scheduled for commissioning between now and 2012, including $33 million for the new Carleton wind farm.

To optimize interchanges with neighboring systems, Hydro-Québec TransÉnergie is planning or building new interconnections.

- In 2008, we devoted $249 million to work on the future interconnection with Ontario, which will nearly double our export capacity to that province and improve the reliability of native load transmission service here in Québec. We also continued to study the feasibility of a new interconnection with New England.

For 2009, total investments of nearly $1,500 million will be required to meet customers' needs. Of that, 45% will go to facility maintenance and improvement, and 55% to developing the grid. In the coming year, Hydro-Québec TransÉnergie plans to:

- complete construction of Outaouais substation, which is part of the interconnection with Ontario, connect Saint-Ulric wind farm, and commission Mont-Tremblant and Vaudreuil-Soulanges substations;
- begin the rollout of automated equipment maintenance based on digital technologies such as remote monitoring, telemetering and remote diagnostics.

Construction of Outaouais substation should be completed in 2009.

The 735-kV Chénier–Duvernay line under construction.

Portfolio of Hydro-Québec TransÉnergie's Projects

Under construction	Commissioning	Investment
Expansion of 315/25-kV Saraguay substation	2008–2009	$39 million
New 1,250-MW interconnection with Ontario (line and substation) – Phase I	2009	$440 million
New Mont-Tremblant substation and related projects	2009	$52 million
New Vaudreuil-Soulanges substation	2009	$30 million
Saint-Maxime substation – Refurbishment and increase in transformer capacity	2009–2010	$42 million
New 1,250-MW interconnection with Ontario (line and substation) – Phase II	2010	$214 million
New Anne-Hébert substation and new Jacques-Cartier–Laurentides line	2010	$84 million
Sorel substation – Major refurbishment	2010	$54 million
Integration of wind farm output following Hydro-Québec Distribution's first tender call	2007–2012	$521 million
Connection of Eastmain-1-A and Sarcelle powerhouses	2011	$176 million
Hauterive substation – Refurbishment and increase in transformer capacity	2009–2011	$79 million
Under approval		
Reinforcement of bulk transmission grid	2010–2012	$251 million
Abitibi substation – Refurbishment of synchronous condensers	2011	$71 million
Integration of output of Rivière-des-Prairies generating station	2010	$33 million
New Waconichi substation	2010	$36 million
Under study		
Integration of wind farm output following Hydro-Québec's second tender call	2010–2015	
Chomedey substation – Addition of fourth 315/120-kV transformer	2011	
Connection of Romaine complex	2014–2020	

The Eastmain-1-A/Sarcelle/Rupert development will add 918 MW to Hydro-Québec's installed capacity and 8.7 TWh to its annual output.

Portfolio of Hydro-Québec Production's Major Projects

Under construction	Commissioning	Construction	Capacity	Output	Investment
Chute-Allard and Rapides-des-Cœurs hydroelectric developments Region: Mauricie	2008–2009	2005–2009	138 MW	0.9 TWh	$1.0 billion
Eastmain-1-A and Sarcelle powerhouses and Rupert diversion Region: Nord-du-Québec	2009–2012	2007–2012	918 MW	8.7 TWh	$5.0 billion[2]
Under approval					
Romaine complex Region: Minganie	2014–2020	2009–2020	1,550 MW	8.0 TWh	$6.5 billion[2]

1. In addition to these major projects, some 40 projects to refurbish or add generating facilities were under way in 2008.
2. Including agreements with local and Aboriginal communities.

System Map

Generating station rated 300 MW or more
Other facilities
La Grande-2-A
La Grande-1
Robert Bourassa
La Grande-3
La Grande-4
Laforge-2
Laforge-1
Sarcelle
Eastmain-1
Eastmain-1-A
QUEBEC
To Churchill Falls G.S. A (interconnection)
Romaine complex (planned)
Sainte-Marguerite-3
Manic-5-PA
Manic-5
Toulnustouc
Manic-3
Outardes-4
Outardes-3
Manic-2
Outardes-2
Péribonka
Bersimis-1
Bersimis-2
Chute-Allard
Rapides-des-Cœurs
Trenche
Gentilly-2
Bécancour
Tracy
Carillon
La Citière
Beauharnois
ONTARIO
NEW BRUNSWICK
PRINCE EDWARD ISLAND
NOVA SCOTIA
MAINE
VERMONT
UNITED STATES
NEW HAMPSHIRE
NEW YORK
MASSACHUSETTS
PENNSYLVANIA
CONNECTICUT
R.I.
NEW JERSEY
Lake Ontario
Atlantic Ocean
0 75 150 km

Glossary

Annual peak load

The highest load of the year. Hydro-Québec's annual peak occurs in winter, largely because of the use of electric heating.

Capacity

The quantity of electricity that is or can be produced at a given moment by a generating station. It is generally expressed in watts (W), kilowatts (kW) and megawatts (MW).

Connection

The action of connecting the customer's service loop to the distributor's service loop or to the grid.

Dividends

Under the *Hydro-Québec Act*, the dividends to be paid by Hydro-Québec are declared once a year by the Québec government, which also determines the terms and conditions of payment. For a given financial year, they cannot exceed the distributable surplus, or no more than 75% of the year's net operating revenue and net investment income, less interest on debt securities and amortization of debt premiums, discounts and issue expenses. This calculation is based on the consolidated financial statements.

Energy

Energy is the power consumed during a given time. It is generally measured in kilowatthours (kWh), megawatthours (MWh) and terawatthours (TWh).

Energy efficiency

Load management through incentive programs aimed at rationalizing electricity use by consumers, in keeping with the company's objectives.

Energy reserves

Accumulated inflows of water eventually intended for electricity generation.

Heritage pool

The annual maximum volume of 165 TWh provided to Hydro-Québec Distribution for Québec customers at a price of 2.79 cents per kilowatthour, as set out in a law passed in 2000.

Installed capacity

Total rated capacity that a facility's generating equipment can supply. It is generally expressed in megawatts (MW).

Interconnection

Installation allowing interchanges with neighboring power systems.

Multiyear management

To reduce the impact of extended periods of energy surpluses or deficits, reservoirs managed on a multiyear basis allow the storage of surpluses created by strong runoff or weak demand. Multiyear reserves are used at times of below-average runoff or strong demand.

Net electricity exports

Income generated by net reservoir drawdown (in TWh) for electricity exports, and calculated by subtracting imports from exports.

Regulatory deferral

The recognition of the decisions of the Régie de l'énergie affects the timing of certain transactions in Hydro-Québec's financial statements. This results in the recognition, in a given period, of amounts to be received from or paid to customers, which will be recovered or settled in subsequent years through the rates set by the Régie. These amounts are called "regulatory deferrals."

Synchronous condenser

A machine running without mechanical load and used to reduce voltage losses and drops on a power system.

Water-power royalties

Amounts paid by Hydro-Québec Production to the Québec government under the terms of the *Watercourses Act*. They have been applicable since 2007 to all hydropower producers in Québec and are calculated on the basis of kilowatthours generated in the province.

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